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SUBJECT: PRE-ELECTION TELECOM PRIVATIZATION CREATES STOCK MARKET
FRENZY

1. Summary: The further privatization of Croatian telecom (HT), in which Croatian citizens can buy shares at a fixed and probably discounted price, has set off a stock frenzy in the country. Croatians have been lining up to buy shares in the company, certain that their government will price them at a sufficient discount to ensure a quick gain. This new-found euphoria for securities has been buttressed by last year's partial privatization of the energy company INA, in which citizen investors realized a first day gain of nearly fifty percent. Investor confidence is further bolstered this time around by the fact that this privatization precedes parliamentary elections, thus providing a strong incentive for the Government to underprice HT shares. End Summary.

2. From September 17 to 27 Croatian citizens can register to purchase shares in the latest round of the privatization of the national telecoms provider, HT. The Croatian government is a minority shareholder in HT, with Germany's Deutsche Telekom holding 51 percent of shares. In this latest offering, the GOC is selling up to 23% of the shares in the company at a price of between HRK 245 and HRK 320 per share (5.25 HRK = 1 USD). The Government will set the final sale price for the shares on October 1, days before their simultaneous October 5 listing on the Zagreb and London stock exchanges. Croatian citizens are eligible to purchase up to HRK 38,000 worth of shares. The Government has also committed to give an additional share to each shareholder for every 10 shares held for one year.

3. The privatization of HT has sparked a frenzy across the country, with people from all walks of life standing in line for hours to buy shares. Stock ownership is not widespread in Croatia and for most of those queuing to buy HT shares, this is their first foray into the market. One reason for the excitement is last year's privatization of the national energy company INA, in which the Government sold shares to citizens at what proved to be a substantial discount. Those who bought INA shares last year realized a 50 percent gain the first day of trading. Convinced that past is prologue and that a government facing elections in two months would not allow thousands of voters to lose money, most Croatians are certain that HT will prove a winner. Banks have also jumped into the game, offering credits at 10 percent interest for HT share purchases.

4. The Government's objectives in the sale are several and, if all goes according to plan, the timing is quite propitious. Proceeds from the sale of HT are to be used to pay a final installment of a state "debt" to pensioners (these are pension arrears that were not paid through the 1990s and which the Supreme Court mandated the Government to repay several years ago). With one pensioner to every one and a half people working, pensioners are an important voting block. Selling shares at a discount and guaranteeing quick gains among voters (even among these very same pensioners who are taking loans against their "debt" repayments to buy shares) so soon before

an election can only help the ruling party. Finally, this public IPO is also a way of partially atoning for the sins of the murky privatizations of the 1990s, in which the well-connected, but not necessarily the well-qualified, were able to acquire vast wealth in a short time, leaving a decidedly negative attitude towards privatization among the public.

15. COMMENT: The privatization of HT is not without risks. Some analysts have pointed out that HT is quite different from INA, that it already has a majority shareholder and that it is operating in a much more competitive industry. HT's long-term profitability is anything but certain and the practice of taking loans to buy shares only increases the risk that some investors will incur losses on the transaction. Politically, the deal also gives an opening for the opposition to charge the Government with pandering to voters at the expense of the state should the share price turn out to be low. In the short term, however, the intense demand for shares seems almost certain to drive their price higher and most voters will probably happily be pandered to if the result is a nice tax free gain on their investment. END COMMENT.
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